United Nations A/61/826

General Assembly

Distr.: General
29 March 2007

Original: English

Sixty-first session
Agenda item 117
Programme budget for the biennium 2006-2007

Feasibility of the application of cost-accounting principles in the United Nations Secretariat

Report of the Secretary-General

Summary

The present report is submitted in response to the request of the General Assembly, in its resolution 59/275, for the Secretary-General to report on the feasibility of the application of cost-accounting principles in the United Nations Secretariat.

The report explores ways to apply cost-accounting techniques to the Secretariat. It also considers the broader financial management framework with respect to cost accounting, including mechanisms for regulating cost recovery, and the financial frameworks for income received through cost-recovery mechanisms.

The General Assembly may wish to take note of the report, and revisit this issue in the context of determining the relative priority of the benefits to be achieved by the implementation of the new Enterprise Resource Planning (ERP) system.

07-28881 (E) 100407

I. Introduction

1. In its resolution 59/275, the General Assembly requested the Secretary-General to report on the feasibility of the application of cost-accounting principles in the United Nations Secretariat. The note by the Secretary-General on the introduction of a cost-accounting system (A/60/714) set out the interim progress made in fulfilling the request, including the completion of the technical work for the review by consultants.

2. Building upon the findings of the consultants in the technical review, this report explores the feasibility of the application of cost-accounting principles in the United Nations Secretariat, in the context of the ongoing efforts to prepare for the implementation of the new Enterprise Resource Planning (ERP) system, and to comply with International Public Sector Accounting Standards (IPSAS).

3. The report focuses on the different activities undertaken by substantive departments and support services, respectively. It finds that the broad application of cost-accounting techniques would involve not only time recording and costing, but also activity-based costing. The report considers the current methodologies and practices for cost accounting, and discusses the broader issue of whether a more standardized approach to cost-recovery policies and practices is required.

II. Degree of acceptability of cost-accounting principles

4. Although there is no cost-accounting system in general use in the United Nations Secretariat, related principles are applied in many areas, albeit using differing methodologies. Most of this is "behind the scenes" cost-accounting work performed by budget officers within the Office of Programme Planning, Budget and Accounts, the substantive departments, their executive offices, and other United Nations offices. Where costing is routinely undertaken, it has been adopted principally to raise charges for non-regular budget activities for which extrabudgetary resources are to be requested, or for cost-recovery purposes, mainly on an ex post facto basis. Costing is also applied by the Department of Peacekeeping Operations for determining standard set-up costs of new operations and the monthly charges for military and police contingents. Standard costs are also established for budget preparation purposes, and hence the concept of standard costing is firmly embedded.

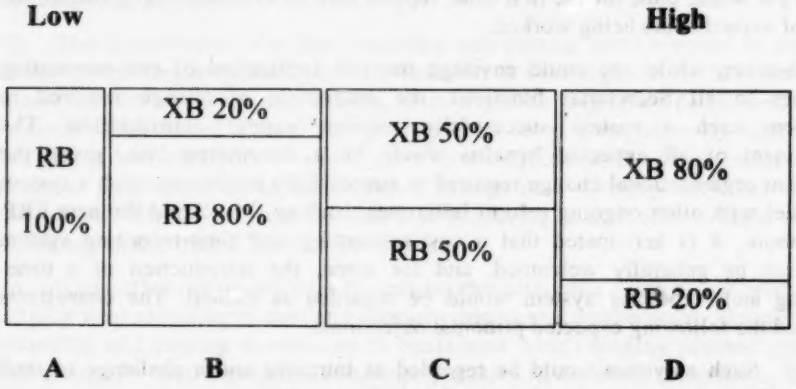
5. There is widespread interest in improving reporting on the costs of activities and outcomes. In line with results-based budgeting, many units seek to improve the relationship between budget performance reporting, which reports costs against budget lines, and programme performance reporting, which reports on outputs. Similar interest has arisen with respect to peacekeeping operations, where requests are made to provide a cost breakdown by component (for example, political, security, governance, humanitarian relief, support).

6. In a few cases, such as telecommunications, information technology (IT) helpdesk support, and conference services at the United Nations Office at Nairobi, full-cost recovery through a charge-back system is also in use. However, in an earlier report (A/57/348), the Secretary-General concluded that there was no compelling reason to extend the concept of cost recovery because, inter alia, full

financial decentralization (through a charge-back system) would give rise to the need for additional funds to create operating reserves.

7. The creation of an operating reserve is a requirement where functions are to become self-financing (see para. 31), with full integration of the charge-back system within the financial accounting system. The consultants observed that the vast majority of organizations do not attempt this level of integration between financial and management accounting systems. For the Secretariat, costing may draw upon information from the financial accounting system but does not have to be fully integrated with that system. The primary aim of costing is to assist in determining the cost of different activities and outcomes, not cost recovery, though it is useful for that purpose.

8. The widespread concern about the sources of funding also has a bearing upon the acceptance of charging for support services. In general, the principle of establishing separate extrabudgetary programmes and setting up extrabudgetary accounts to service them has led them to be regarded as the activities that give rise to "marginal" costs,[1] while the regular budget represents the "fixed" costs.[2] The chart below illustrates the review's finding that the greater the dependence on extrabudgetary (XB) funding, the greater the interest in adopting a full-cost recovery approach. Sections and units funded mostly by the regular budget (RB), as in A and B, tend not to rely upon cost recovery, while those with greater reliance on extrabudgetary funding do. As the paradigm shifts towards very heavy dependence on extrabudgetary funding, full-cost recovery becomes essential.



III. Rationale for applying cost-accounting principles

9. The main justification for the application of cost-accounting principles is better management of costs and utilization of time. In addition, there may be other benefits, such as:

[1] The Chartered Institute of Management Accountants (CIMA) defines "marginal cost" as "The cost of one unit of product or service which would be avoided if the unit were not produced or provided".

[2] "Fixed cost" is defined by CIMA as "The cost which is incurred for a period, and which, with certain output and turnover limits, tends to be unaffected by fluctuations in the level of activity".

(a) Increased revenue generated by support services where charges are levied, for example conference and IT services, arising from the revision of tariffs to include overheads, and from a broadening of the scope for charging (see paras. 25-33);

(b) Savings in time and other costs arising from changes made in response to realization of the true costs of substantive and support activities. These could take the form of projects that are terminated, reduced duration of meetings and conferences, and briefer reports;

(c) Improved project management through the use of cost-accounting information;

(d) Improved cost information for the preparation of budgets;

(e) The fact that the initiative would reflect positively on the Organization by publicly demonstrating its efforts to achieve increased accountability and improved cost effectiveness, and allow reporting on the costs of specific mandated activities.

10. Intangible benefits may also accrue. A cost-accounting and time-recording system would help record the range and depth of work covered by any given section that is not readily understood outside. By providing a summary of each person's time over a defined period, it may assist human resources management and performance appraisal discussions, by identifying all the projects and programmes that staff have worked on over the period. The system may also detail the hours worked per week; thus, for the first time, reports may be available that illustrate the extent of unpaid hours being worked.

11. However, while one could envisage the full application of cost-accounting principles to all Secretariat functions, the magnitude of change required to implement such a system successfully requires careful consideration. The achievement of all expected benefits would be a demanding task, given the significant organizational change required to successfully implement such a system in parallel with other ongoing reform initiatives, such as IPSAS and the new ERP. Furthermore, it is anticipated that a cost-accounting and time-recording system would not be generally welcomed, and for some, the introduction of a time-recording and -reporting system would be regarded as radical. The consultants identified the following expected principal objections:

(a) Such a system would be regarded as intrusive and a challenge to staff members' integrity in regard to the use of their time;

(b) It would be an additional chore on top of an existing busy work schedule;

(c) Many staff may work more than the standard 40 hours, yet the costing system would use standard time-charge rates based on a 40-hour week;

(d) A doubt about the net benefits, linked to;

(e) The suspicion that the system is intended to measure productivity and eventually to lead to a reduction in staff.

12. To be able to use the new applications and interpret the new data that these applications may yield, finance staff, especially budget officers, would require training in management-accounting principles and practices. Introducing a time-

based costing system would mean strengthening and reorienting the function of the present budget units in order to apply management-accounting principles, alongside their duties in budget preparation and control. Moreover, they would use cost-accounting methods and systems to prepare reports that would provide managers with information enabling them to use their resources and control costs more effectively.

13. Any changes in support of cost-accounting principles would also require integration with the parallel changes arising from the adoption of IPSAS, the implementation of ERP, and other ongoing and potential reform initiatives, including changes to human resources practices, an internal control framework and enterprise-wide risk management. In the absence of dedicated change-management resources, an effective separate project-management team would need to be established to take primary responsibility for the implementation of the project and manage its interrelation with other initiatives.

IV. Costing in the substantive departments

14. Looking at the Secretariat as a whole, expenditure on staff costs is the largest and most critical resource of the Organization. Since the core business of the Secretariat is executed by the substantive departments, within the framework of projects and programmes, it is in those areas that a system recording and costing the time utilization of professional staff would be required in order to determine their activities and outputs.

15. The introduction of a time-recording and costing system would improve the ability of the Organization to identify and cost at a strategic level the utilization of funds, i.e. the activities and outputs, with a greater degree of detail than present systems which record costs to the subprogramme level. Such improved alignment of budgetary data with outputs would serve to strengthen results-based budgeting and promote progress towards results-based management. Conceptually, the effective use of staff time is an important driver in achieving overall effectiveness and cost efficiency in the United Nations Secretariat.

16. Some other organizations with similar characteristics, such as the World Bank, employ time recording to cost and control projects and programmes. Moreover, time recording and costing is common in businesses which employ professional skills and charge for their services. Accountants, architects, auditors, computer specialists, consulting engineers, investment bankers, lawyers, management consultants and many other professionals use time and expense costing to support their businesses.

17. Yet while the concept is tried and tested elsewhere, the Secretary-General concurs with the consultants' view that the application of such a system in the Secretariat would face significant challenges. Time recording would affect a large number of staff. By far the biggest challenge in implementing such a system would be gaining acceptance for it from management and staff alike:

(a) Managers would need to be convinced of the need for the system and its usefulness to them in a non-profit environment. They would have to review time-sheet reports and act upon the cost reports that are produced;

(b) Staff generally would need to be persuaded of the importance of time discipline and improved management information in helping to enhance efficiency.

18. Furthermore, an important element in determining the costs of outputs and activities of the substantive departments is their use of support services, and generation of other overheads.[3] All substantive departments require offices and a full range of support services. Yet the true level of overhead usage is not reflected in the costs of their outputs and activities. As a rule of thumb, the typical cost of overheads tends to be nearly equal to the cost of professional staff salaries (see paras. 34-37 below).

19. Given the above, should cost accounting be required for substantive departments, it would need to be preceded by the application of cost-accounting principles to all support services (see paras. 25-33 below).

V. Costing support services

20. In many support-service areas, costing systems have already evolved to suit the needs of each office. Offices away from Headquarters, such as the United Nations Office at Geneva, have a detailed scale of charges for support services that includes overheads.[4] Other cost-sharing entities are aware of the bases for allocating overheads and are generally satisfied with the methods employed.

21. In comparison, the consultants found there to be greater scope at Headquarters for extending the use of cost accounting and, at the same time, for examining the bases for setting rates for support-services charges. Apart from rent, telecommunications and IT helpdesk charges, virtually all charges at Headquarters are levied either on a virtual marginal-cost basis or in a token amount, and in no case are overheads taken into account. Therefore, non-Secretariat users of support services at Headquarters are effectively subsidized.

22. Some support services have deliverables that are time-based (such as internal audit, investigations, and information-systems development); others require time costing in relation to throughputs (such as average time for processing a given number of invoices or job applications or for mail delivery). Yet this is not the case for the majority of support services that collectively represent a wide and diverse range of functions, including provision of legal advice, air transport operations, collection and dissemination of economic and social statistics, cleaning services, procurement, security, and sale of merchandise to visitors. Different cost-accounting techniques and costing methods are therefore required depending on the function.

23. Most support services would require costing methods that use a combination of time-, activity- or standard-based costing practices. As with any cost-accounting system, there is a trade-off between the extra effort required to identify the usage of costs, and the benefit to be gained from the information. A commonsensical, practical approach would be needed, which includes the allocation of some costs of support functions, and for others the establishment of standard costs and charging for these on the basis of actual usage.

24. To strengthen the existing practice of cost accounting, and to widen the application of cost-accounting principles to all support services, it would be

[3] CIMA defines "overhead" as "Expenditure on labour, materials or services which cannot be economically defined within a specific saleable unit".

[4] Overheads include capital expenditure (in lieu of depreciation) but exclude notional rent.

necessary to review in detail the appropriate basis for costing all support services, and to assess the need to include overhead costs, as explored in further detail in paragraphs 25 to 33 and paragraphs 34 to 37, respectively. Other improvements to the financial framework may also merit consideration, including the implementation of a strengthened framework for practice and approval in regard to setting of charges for cost-recovery purposes and the development of proposals for appropriate financial frameworks for functions that recover costs (see paras. 30-33 below).

VI. Cost recovery for services within the Secretariat

25. While wider financial, management and authority frameworks are laid down clearly, a consistent policy on recovery of costs (or internal charging) for services has yet to be established. Cost-recovery policies have evolved piecemeal over time and, as a result, may not collectively reflect optimum financial practice.

26. The following are illustrations of current approaches taken in cost recovery:

(a) IT services charge back to departments significant usage in excess of budget. Detailed cost control is applied using a system outside the Integrated Management Information System (IMIS);[5]

(b) Telecommunications are charged out monthly, based on telephone usage at a standard rate. The aim is to ensure full-cost recovery;[6]

(c) The Mail Operations Unit recharges the cost of external courier services but, apart from partial cost-sharing with the United Nations Development Programme (UNDP) and the United Nations Children's Fund (UNICEF),[7] does not otherwise raise charges for its services;

(d) The Garage Administration charges delegates and missions only for overnight parking and United Nations staff for day parking. Parking charges have not been revised since January 1994 (and, even then, only for United Nations staff);

(e) Rent for tenants is based on the highest rent paid anywhere by the United Nations Secretariat, as this is deemed to be the market rate. When compared with the examples above, especially (d), this underlines the inconsistency in charging practices.

27. A transparent policy and mechanism may be desirable to regulate areas that intend to introduce charging, to determine whether cost recovery is appropriate, and if so to establish the basis for the charges. Best practice dictates that a standardized policy and methodology should be determined for each type of service that regulates the practice and process of setting charges both internally and externally. While a

[5] IT services are seeking to charge all services back to departments on a usage basis in order to provide funds for continuing and future IT investment. At present the fund allocation from departments at the beginning of the biennium does not cover continuing service improvement but is based on historical costs.

[6] A separately controlled fund is used for this purpose. The fund is currently in credit, with the aim of providing for future development expenditure. However, user departments are not always satisfied with the lack of transparency in the rate charged. This is the only case of a full-cost recovery policy in New York.

[7] UNDP and UNICEF fund some of the posts in the Mail Operations Unit through an OJA account.

single cost-recovery policy would be inappropriate across all units of the Secretariat, consistency in approach and transparency in the principles applied may be beneficial. Such a policy would ensure that:

(a) Management controls and procedures exist to authorize the setting of charges;

(b) Charges are set consistently and appropriately;

(c) Costs are not over-recovered or under-recovered;

(d) The charging regime maximizes the utilization of resources;

(e) Where applicable, competition with external suppliers is fair, i.e. not subject to cross-subsidization.[8]

28. In general, it may be considered that where a competitive market exists for a given internal service, programme managers should be able to choose between an internal or external supplier and a full-cost recovery policy should apply. Where user departments do not have such a choice and must use internal service providers, services should be supplied either free of any cost or subject to marginal cost-recovery policies. The option to vary charging policies where local factors justify some variation should nevertheless be retained.

29. Quality assurance and performance measurement are important components of the financial framework for functions that are permitted to levy charges. For services or functions that recover a significant proportion of their costs internally, or are entirely self-financing, quality could be further assured by empowering programme managers to purchase the service from any service provider, whether internal or external to the Organization. This practice would also strengthen the accountability of departments that use services, in that options are available to them for meeting their responsibility to secure value for money in the provision of services, and to manage the scarce resources of the Organization in an optimum manner.

30. Furthermore, it may be questioned whether the financial flows that result from internal charges must also be consistent with mandates. The receipt and redistribution of funding outside the budgetary appropriation mechanism has the potential to muddy the existing allocation, and may technically result in expenditures occurring outside the original purpose for which it was intended (ultra vires), or in capped expenditure provisions being exceeded for certain programmes or services.

31. The implementation of more consistent and uniform charging practices is likely to generate increased income. To deal with the potential conflict between income and appropriations, distinct financial control frameworks may need to be developed for internal entities that are authorized to generate income. Such financial frameworks may have the following characteristics:

[8] Cross-subsidization would lead to an increase in the cost of services to Member States, and unfairly restrict departments from using external suppliers that may offer the best value for money.

(a) Strict guidelines and policies on the application of cost recovery;

(b) Control of the staffing table and wider running costs through distinct financial regimes[9] that vary according to the level of cost recovery:

(i) Gross: income cannot be used for expenditure;

(ii) Net: provision is made for expenditure based on estimated costs less forecast income earned;

(iii) Unfunded: income is used to fund expenditure, resulting in the function being self-financing;

(c) Management information requirements are tailored to the funding regimes;

(d) Incentives are provided to managers and staff for the efficient use of resources;

(e) Performance is measured and monitored through the creation of strategic control framework agreements that set targets, measure outputs and hold management accountable for delivery.

32. In this scenario, the appropriate charging regime would be agreed in parallel with the implementation of suitable funding regimes and budgetary appropriation and reporting mechanisms ensuring that the resultant income and expenditure reflect the intentions of Member States. The consequent policies would then be applied consistently by all United Nations offices,[10] over time.

33. Secretariat functions now exist that have income-generating activities, and may benefit from an appropriate financial framework. Where functions could become self-financing, the resultant financial framework would help facilitate the possible assessment of options for alternative-service provision. Furthermore, other services could progress towards such a financing arrangement over time, especially where the future potential for alternative-service delivery options exists.

VII. Overhead allocation

34. The core activities of the United Nations Secretariat are undertaken by the substantive departments, such as the Department of Peacekeeping Operations, the Department of Political Affairs and the Office for the Coordination of Humanitarian Affairs. These substantive departments require offices and a broad range of support services — from accounting services, archives and records to training and travel and transportation — that generate overheads.

35. The consultants determined one existing difficulty in the allocation of overheads to be that the incidence of such costs is not always understood. At present, overheads are omitted from Headquarters costing in the great majority of cases, and the true level of overheads is not generally appreciated. The consultants further observed that most outside firms have found, over time, that overheads tend

[9] Net and unfunded financial regimes would require the establishment of an operating reserve (see A/57/348).

[10] Unless there are unique factors that would justify a policy variation in a particular location; in that event, the policy should be clearly set out and approved.

to be nearly equal to the cost of professional staff salaries (this has been a rule of thumb for over a century). Accordingly, at Headquarters, the cost of support staff and other departmental costs (including telecommunications and Information Technology Services Division charges) of the non-substantive departments may not be far off the cost of professional staff in the substantive departments.

36. For extrabudgetary activities, the programme support-cost reimbursement for services provided is the United Nations mechanism for partial-cost recovery from outside users. The consultants considered that the percentages provided appear inadequate for typical programme volumes and values to cover the actual costs of, say, auditing and separate reporting on a full-cost recovery basis. Assuming that such programme support-cost rates cover only a marginal effect, the overheads must continue to be borne elsewhere.

37. Where cost-accounting principles are to apply, all overheads should be taken into account in establishing standard costs and charge rates for time recording and other costing systems.

VIII. International Public Sector Accounting Standards and cost accounting

38. In the context of the changes needed to comply with IPSAS, the information provided by the financial management system to support managerial decision-making will require substantial review. In this regard, there is a distinct and important difference between financial and management accounting. The financial accounts report funding and expenditure only for the relevant financial period (one or two calendar years) and do not reflect cumulative project and programme costs from one biennial reporting period to another, or compare expenditure with non-financial performance indicators. A management accountant tracks and reports on the cost of a project/programme, in relation to budget and monitorable measures of progress, from inception through to completion. That may spread over a period of years. The current basis for accounting, the United Nations System Accounting Standards (UNSAS), in many ways facilitates some of the information required by management through its practice of obligation accounting.

39. Managers throughout the Secretariat need management-accounting information to perform their jobs optimally, especially to manage projects and programmes. In particular, managers in the substantive departments should receive reports on the cumulative cost of projects and programmes for which they are responsible so that they can track those costs against budget and progress. This information would help them gauge staff performance and alert them to impending project cost overruns. They would then be in a better position to determine whether the problem results from internal inefficiency or whether there are other factors making for an increase in time and costs, and inform senior management of the remedial action they propose to take.

40. An in-depth review of management-accounting information will be required in the context of the implementation of IPSAS, and the new ERP, so as to better serve the needs of managers. Such a review may include the need for cost-accounting information.

IX. Information systems options

41. It may be possible to conceive of a highly sophisticated process-costing system that, in addition to an elaborate time-recording system (including, for example, linkage to computer usage), would track, in detail, the cost of every document generated and processed, and cost every item handled, every process carried out and, finally, every activity and output. However, such a system is not within available IT capabilities, and the enormous investment required for its development renders it non-feasible.

42. The more feasible technical options available for time recording and cost accounting fall into four main categories:

(a) An in-house system;

(b) A proprietary, commercial, off-the-shelf system;

(c) An ERP system;

(d) A combination of one or more of the above.

43. While the consultants viewed an in-house system as the most feasible solution at the time of writing their report, the Secretary-General now considers this option not to be practicable given the recent decision of the General Assembly to replace IMIS with a new ERP system, to achieve the benefits of integration of systems sought through implementation of the ERP project. Were the General Assembly to decide that the Organization should implement cost accounting, the business requirements for the ERP solution could be formulated to contain the time-recording and -reporting, costing, cost- and management-accounting elements needed. While an ERP system would have the benefit of being fully integrated, tried and tested, there is a risk that additional customization and tailoring may be necessary. Moreover, the additional software costs for an ERP solution would be difficult to estimate, given that the time-recording, time-costing and cost-accounting components would be rolled into the development and implementation of the entire system.

X. Conclusions and recommendations

44. **The Secretary-General recommends that the application of cost-accounting principles across the Secretariat be considered further in the context of the implementation of the new ERP system. At this stage it is too soon to be able to assign a relative priority to cost accounting within the range of other possible improvements arising from the implementation of a new ERP, or to say in what phase of the implementation process such improvements would occur.**

45. **Looking forward, should the General Assembly consider it important for the Organization to apply cost-accounting principles, the Secretary-General recommends that such principles be applied initially to all support services, following an examination of the bases for costing support services and the adoption of a standard approach for such costing. The option of extending cost accounting, and in particular time recording, to peacekeeping activities and other programme areas should be examined at a later date following a review of**

the success of the implementation of the cost-accounting systems for support services within the new ERP system.

46. **In conclusion, the General Assembly may wish to take note of the present report and to:**

(a) **Take note of the ongoing changes to management information needs that will be among the results of the process of moving from IMIS to an ERP, and from compliance with UNSAS to observance of IPSAS;**

(b) **Review the implications of the application of cost-accounting principles, and decide to return to this issue in the context of determining the relative priority of the benefits to be achieved by the implementation of an ERP system, including the strengthening of financial-management frameworks at the Secretariat with respect to internal charging and cost-recovery practices.**